Earnings Review

October 29, 2020

Howard Bancorp, Inc. (HBMD - NASDAQ - Recent Intraday Price: $9.48)

HBMD: A Clean Quarter Shows Bank's Earnings Power, We Still Anticipate NIM Stability and Market Share Growth. Discontinuing Coverage.

3Q20 Results: Howard Bancorp reported 3Q20 net income of $4.6 million compared to the 2Q20 net loss of $(29.4) million. This translates to EPS of $0.25 in 3Q20 compared to $(1.57) in 2Q20. The 3Q20 results were free of any significant one-time or irregular items, but there were several significant irregular or non-recurring items affecting 2Q20 results. The biggest was a goodwill impairment charge of $34.5 million or $1.84 per share. In addition, a litigation reserve and FHLB prepayment penalties amounted to $1.2 million pre-tax or a $0.05 cut to EPS. Offsetting these to some extent were securities gains of $3.0 million, which provided a boost of $0.12 to EPS. Excluding these nonrecurring items from the prior quarter, "adjusted" EPS was $0.25 in 3Q20 and $0.20 in 2Q20. Adjusted 3Q20 results exceeded our $0.20 estimate by $0.05 and the median Street estimate by $0.10. The outperformance versus our estimate was primarily due to a lower-than-expected loan loss provision, but higher net interest income and higher noninterest income also contributed, offset partially by higher-than-expected noninterest expenses.

Highlights from the quarter include:

- Net interest income was $18.3 million in 3Q20, up 0.8% compared to the prior sequential quarter. Average earning assets climbed 1.8% from the prior quarter while the NIM contracted 7 basis points sequentially to 3.15%. Fair value adjustments on acquired loans contributed 10 bps to the NIM this quarter, up from 9 bps in the prior quarter. The main driver of the NIM contraction was a 14 bps decrease in the average yield on loans. Average residential mortgage loan yields fell 30 bps sequentially and consumer loan yields declined 21 bps sequentially. In addition, a full quarter of low-yielding PPP loans reduced average loan portfolio yields by 18 bps, up from 13 bps in the preceding quarter. Meanwhile, AFS securities suffered a 54 bps decline in average yields. This drove a 19 bps reduction in average earning asset yields. Meanwhile, the cost of interest bearing liabilities was down 18 bps compared to 2Q20, as a 21 bps drop in the average cost of deposits combined with a 13 bps drop in the cost of FHLB borrowings.
- Noninterest income fell $2.7 million or 56.1% linked-quarter to $2.1 million. The decrease was primarily due to $3.1 million in securities gains recognized during the prior quarter. Excluding securities gains, "core" noninterest income rose $0.4 million or 22.2% linked-quarter due to a $0.2 million rise loan-related income, a $0.1 million increase in "other" fees and noninterest income, and growth of $0.1 million in service charges on deposit accounts.

Market Data		Earnings Per Share Data					
				Our Forecast		Consensus	
			2019A	2020E	2021E	2020	2021
Market Value (M)	$180	1Q (Mar.)	$ 0.22	$ 0.18	$ 0.23	$0.22	$0.12
ADTV (Shs)	39,058	2Q (Jun.)	$ 0.11	$ (1.57)	$ 0.22	$0.14	$0.09
ADTV (000')	$374.2	3Q (Sep.)	$ 0.24	$ 0.25	$ 0.23	$0.17	$0.11
52 Week Range	$8.44-$18.87	4Q (Dec.)	$ 0.31	$ 0.25	$ 0.23	$0.18	$0.14
Dividend Yield	0.00%	Year	$ 0.89	$ (0.89)	$ 0.91	$0.67	$0.47
		P / E	10.8	(10.8)	10.5	14.3	20.5

Fundamental Metrics (MRQ)	
Balance Sheet	
Total Assets (M)	$2,463
Gross Loans HFI (M)	$1,899
Total Deposits (M)	$1,831
Loans / Deposits	104%
Securities / Assets	12%
Debt / Assets	9%
Profitability	
FTE NIM	3.22%
Nonint. Income / Revenue	9%
Efficiency Ratio	56%
Core ROAA	0.73%
Core ROACE	-35.87%
Credit Quality	
NPAs / Assets	0.71%
NPLs / Loans	0.90%
NCO Ratio	0.01%
Reserves / Loans	0.86%
Provision / Avg Loans	0.64%
Capital Adequacy	
TCE / TA Ratio	10.1%
Total Capital Ratio	14.1%
Tier 1 Ratio	11.7%
Tier 1 CE Ratio	11.7%
Leverage Ratio	9.2%
Performance	
Core Value	$12.67
3 Yr. Success Ratio	-33%
Failure Ratio	NA

Source: SNL Financial, Company data

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- Noninterest expenses decreased $34.9 million or 73.3% sequentially. The main causes were a $34.5 million goodwill impairment charge, a $1.0 million accrual for legal expenses related to pre-merger First Mariner mortgage loans and $224k in FHLB prepayment penalties, all of which were incurred in 2Q20. Absent these items, "core" noninterest expenses were up $805k or 6.8% compared to 2Q20. An increase of $877k in compensation was the primary driver.
- The provision for loan losses in 3Q20 was $1.7 million, down 43.3% compared to the $3.0 million recorded in 2Q20. HBMD still operates under the incurred loss model, rather than the CECL model adopted by many larger banks at the beginning of 2020. The bank experienced modest net charge-offs of $78k or 0.02% of average loans during the quarter, compared to $28k or 0.01% of average loans in 2Q20. The loan loss reserve climbed $1.3 million or 8.0% from the prior quarter to $17.7 million. Reserve coverage of total loans (excluding PPP loans) advanced to 1.05% from 0.96% at June 30, 2020, while reserve coverage of NPLs grew to 104.0% from 88.6%.
- NPLs fell $1.5 million or 8.0% sequentially while OREO decreased $1.0 million or 46.0%. Total NPAs (including performing TDRs) declined 12.0% LQ to 0.71% of total assets from 0.84% at June 30, 2020.
- Gross loans held-for investment decreased $14.2 million or 0.7% from the prior quarter. The change included $2.0 million of additional PPP loans originated during the quarter. Absent PPP loans, "portfolio" loans declined $16.6 million to $1.69 billion. The decrease was concentrated in Construction and Land loans, which fell $24.2 million, and residential mortgages, which were down $23.0 million. Partially offsetting these declines was a $22.4 million rise in CRE loans.
- Total deposits advanced $142.1 million or 7.8% in 3Q20. The deposit growth occurred entirely in interest bearing accounts, which rose $156.6 million, while noninterest bearing accounts declined $14.6 million. The bank increased its brokered and other non-customer deposits by $172.1 million sequentially. Management reduced FHLB advances by $46.0 million. The net growth of almost $100.0 million in funding while loans were declining led to an increase of $100.6 million in the AFS securities portfolio. The loans-to-deposits ratio slipped to 95.5% from 103.7% at June 30, 2020.
- Tangible book value per share rose to $13.43 at September 30, 2020 from $13.08 at June 30, 2020. Tangible common equity-to-tangible assets was 9.98% at September 30, 2020 compared to 10.09% at June 30, 2020.
- The total risk-based capital ratio rose 16 bps sequentially to 14.25% while the Tier 1 leverage ratio advanced 34 bps to 9.07%. All of the regulatory ratios remain well above the levels needed to be considered "well capitalized".

Earnings Estimates:

Howard displayed a number of encouraging signs in 3Q20 results, including fairly stable loan balances and increasing line-of-credit utilization. In addition, credit quality shows no signs of deterioration from the pandemic so far. While we still expect to see growing NPLs and net charge-offs beginning in 4Q20 and throughout 2021, the bank has boosted its allowance considerably through the first three quarters of 2020 and we believe that a significant portion of the future COVID-a9-related charge-offs have already been reserved for. As a result, we reduced our provisioning forecast slightly going forward. Expenses grew a bit more than we expected, and staffing additions for the expansion into the Washington market is likely to drive further expense growth. We have boosted our projections of noninterest expenses in 2021 by roughly $2.4 million to $51.2 million. The excess liquidity on HBMD's balance sheet is likely to decline gradually and remain a drag on the NIM in the meantime. We have reduced our NIM forecast for 2021 to 3.10% from 3.22%. Still, we expect some help for the NIM over the next few quarters as low-yielding PPP loans are forgiven and thus removed from the balance sheet while at the same time accelerating the recognition of origination fees.

After making these adjustments, we are raising our 2020 EPS forecast from $(0.94) to $(0.89). If we exclude the goodwill impairment and other “non-core” items from 1Q20 and 2Q20 results, our estimate for “core” 2020 EPS is $0.84, up from $0.78 previously. We are maintaining our 2021 estimate at $0.91 and reducing our 2022 estimate modestly from $1.07 to $1.02.

Outlook:

Howard Bancorp appears to be gaining some traction with its positioning as the locally-based business bank for the Greater Baltimore area. The loan portfolio is holding its own in this difficult time, while providing a base for expansion into the Washington, DC metro area. Asset quality remains solid, and the high proportion of fixed-rate loans in the portfolio is providing some stability to the NIM. With the bank trading well below tangible book value, we believe HBMD remains an attractive investment.

While we have enjoyed covering Howard Bancorp, Inc., shifting corporate responsibilities do not allow us time to provide the same level of diligence to our equity research as we would like. Consequently, we are discontinuing coverage of Howard Bancorp, Inc.

Exhibit 1:

Howard Bancorp, Inc.: 3Q20 Highlights

	Actual Results			Change	
	3Q19	2Q20	3Q20	LQ[1]	YOY
Loans Held for Investment ($000)[2]	1,729,880	1,898,630	1,884,405	-3.0%	8.9%
Total Deposits ($000)[2]	1,655,623	1,830,674	1,972,738	31.0%	19.2%
Average Earning Assets ($000)	1,971,539	2,265,240	2,305,205	7.1%	16.9%
Total Revenue ($000)	22,248	19,829	20,361	10.7%	-8.5%
Net Interest Income ($000)	17,215	18,120	18,272	3.4%	6.1%
NIM (FTE)	3.46%	3.22%	3.15%	-0.07%	-0.31%
Average AFS Securities Yield	3.08%	2.29%	1.75%	-0.54%	-1.33%
Average Loan HFI Yield	4.85%	4.18%	4.04%	-0.14%	-0.81%
Average Cost of Int.-bearing Deposits	1.30%	0.77%	0.56%	-0.21%	-0.74%
Efficiency Ratio	64.1%	235.4%	58.6%	-176.79%	-5.5%
NCO Ratio	0.03%	0.01%	0.02%	0.01%	-0.01%

1. Linked quarter changes for the balances are annualized.

2. Loans Held for Investment and Total Deposits balances are end of period balances.

Source: company filings

Exhibit 2:

Howard Bancorp, Inc.

(Figures in thousanSs except for per share data)

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Fiscal years ending December 31	2017A	2018A	2019A	2020E	2021E	2022E	1Q20A	2Q20A	3Q20A	4Q20E	1Q21E	2Q21E	3Q21E	4Q21E
Net interest income	37,859	66,618	69,310	72,254	71,339	75,008	17,525	18,120	18,272	18,337	17,516	17,618	17,977	18,228
Provision for loan losses	1,831	6,091	4,193	9,281	5,038	5,402	3,445	3,000	1,700	1,136	1,175	1,186	1,327	1,350
Net Interest Income after Provision	36,028	60,527	65,117	62,973	66,301	69,606	14,080	15,120	16,572	17,201	16,342	16,431	16,650	16,878
Non-interest income:														
Service charges on deposit accts	923	2,216	2,747	2,132	2,210	2,418	642	433	506	551	538	534	566	572
Mortgage loan and banking income	11,035	5,245	7,798	1,036	-	-	1,036	-	-	-	-	-	-	-
Loan related income	5,722	5,624	3,934	1,304	677	718	581	175	365	183	164	168	171	174
BOLI Income	760	1,614	1,858	1,772	1,850	1,973	445	441	441	445	452	457	466	475
Gains on sale of loans	86	-	-	-	-	-	-	-	-	-	-	-	-	-
Other fees & non-interest income	998	3,161	4,697	5,926	3,307	3,793	662	3,710	777	777	785	824	840	857
Total non-interest income	19,524	17,860	21,034	12,170	8,043	8,902	3,366	4,759	2,089	1,956	1,939	1,983	2,043	2,079
Total Non-interest expense														
Salaries and employee Benefits	23,573	33,674	32,056	28,972	29,559	31,321	8,441	6,259	7,136	7,136	7,093	7,341	7,488	7,638
Occupancy & Equipment	4,154	10,650	9,077	4,903	5,490	5,827	1,033	1,242	1,301	1,327	1,340	1,360	1,381	1,408
Loan related expense	3,743	3,523	2,700	1,159	1,051	1,127	468	192	247	252	256	261	265	270
Other Noninterest Expenses	13,730	35,265	20,245	52,697	15,059	13,891	4,618	39,935	4,025	4,119	3,782	3,825	3,714	3,738
Total non-interest expense	45,200	83,112	64,078	87,731	51,160	52,165	14,560	47,628	12,709	12,834	12,471	12,788	12,848	13,054
Net Income	7,200	(3,828)	16,881	(16,720)	17,388	19,757	3,343	(29,409)	4,604	4,742	4,357	4,220	4,384	4,427
Per Share Data:														
Diluted Earnings Per Share	0.75	(0.22)	0.89	(0.89)	0.91	1.02	0.18	(1.57)	0.25	0.25	0.23	0.22	0.23	0.23
Dividend	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividend Payout Ratio	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Book Value Per Share	13.47	15.48	16.48	15.66	16.41	17.24	16.85	15.14	15.45	15.66	15.84	16.02	16.22	16.41
Tangible Book Value Per Share	13.23	11.16	12.57	13.69	14.63	15.63	12.91	13.08	13.43	13.69	13.92	14.15	14.39	14.63
Average Diluted Shares OutstanSing (MM)*	9,598	17,557	19,071	18,808	19,025	19,408	18,915	18,791	18,737	18,789	18,883	18,977	19,072	19,167
Profitability Measures:														
Efficiency Ratio	76.78%	94.00%	67.14%	103.73%	60.22%	58.10%	65.98%	235.41%	58.62%	59.18%	59.82%	60.95%	59.95%	60.16%
Return on average assets	0.67%	-0.19%	0.75%	-0.69%	0.69%	0.75%	0.57%	-4.68%	0.73%	0.75%	0.71%	0.68%	0.69%	0.69%
Return on average equity	5.82%	-1.44%	5.54%	-5.49%	5.70%	6.05%	4.27%	-37.06%	6.34%	6.45%	5.94%	5.60%	5.66%	5.62%
Net Interest Margin	3.74%	3.78%	3.50%	3.21%	3.10%	3.11%	3.34%	3.22%	3.15%	3.13%	3.11%	3.10%	3.09%	3.10%
Fee Income % Average Assets	1.82%	0.89%	0.93%	0.50%	0.32%	0.34%	0.14%	0.19%	0.08%	0.08%	0.08%	0.08%	0.08%	0.08%
Average Balances:														
Net Loans	930,449	1,639,878	1,735,112	1,801,721	1,845,032	1,958,420	1,748,035	1,882,274	1,866,748	1,801,721	1,776,189	1,794,091	1,826,635	1,845,032
Interest Bearing Deposits	218,139	429,200	468,975	613,007	600,700	615,771	483,499	671,598	657,028	613,007	606,877	596,560	603,719	600,700
Non-interest Bearing Deposits	645,769	1,256,606	1,245,390	1,292,027	1,324,222	1,408,213	1,305,400	1,159,076	1,315,710	1,292,027	1,272,647	1,285,373	1,305,939	1,324,222
Average Earning Assets	1,012,005	1,763,826	1,980,275	2,251,645	2,299,720	2,410,213	2,108,809	2,265,240	2,305,205	2,327,327	2,282,196	2,277,627	2,304,565	2,334,494
Average Interest Bearing Liabilities	730,976	1,322,679	1,490,887	1,560,205	1,568,116	1,651,307	1,565,432	1,551,743	1,549,916	1,573,730	1,550,898	1,550,219	1,573,893	1,597,454
Asset Quality Ratios:														
Net Charge-offs / Loans	0.24%	0.16%	0.22%	0.07%	0.19%	0.18%	0.11%	0.01%	0.02%	0.15%	0.17%	0.18%	0.20%	0.21%
Nonperforming Assets / Loans	1.57%	1.76%	1.27%	1.08%	1.14%	1.12%	1.11%	1.09%	0.96%	1.08%	1.15%	1.17%	1.19%	1.14%
Reserves / Loans	0.66%	0.60%	0.60%	0.98%	0.97%	0.95%	0.76%	0.86%	0.94%	0.98%	0.99%	0.99%	0.97%	0.97%
Provision /Loans	0.20%	0.37%	0.24%	0.51%	0.27%	0.27%	0.78%	0.63%	0.36%	0.25%	0.26%	0.26%	0.29%	0.29%
Capital & Leverage Ratios:														
Equity / Assets	11.50%	13.00%	13.23%	11.82%	12.34%	12.55%	12.57%	11.50%	11.31%	11.82%	12.11%	12.24%	12.25%	12.34%
Tangible Equity / Tangible Assets	11.30%	9.38%	10.10%	10.33%	11.00%	11.38%	9.64%	9.93%	9.83%	10.33%	10.64%	10.81%	10.87%	11.00%

Disclosure Appendix

Analyst Certification:

I, Joseph Gladue, the primary analyst covering this issuer, certify that: 1) all of the views expressed in this report accurately reflect my personal views about the subject security or issuer, and 2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price, if one is established:

- a weakening of the United States economy and the regional and local economies in which the company conducts operations
- unanticipated loan losses or securities-related losses
- a weakening of local real estate markets or the soundness and liquidity of the securities market for real-estate backed assets
- failure to maintain sufficient excess capital or liquidity to conduct operations
- the effects of trade, monetary, and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System
- the effects of increased inflation, a flatter yield curve, or increased volatility in financial markets
- inability to attract core deposits or continue to obtain third party financing on favorable terms
- adverse legal action against the company or litigation initiated by the company
- inability to successfully integrate acquired operations or to maintain sufficient excess capital post the close of a transaction

Investment Rating Definitions:

Investment ratings reflect the analyst's assessment of the subject stock's return potential relative to the NASDAQ Bank Index. There are three investment rating tiers:

- **Outperform/Buy:** The subject stock's total return is expected to exceed the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.
- **Neutral/Hold:** The subject stock's total return is expected to be comparable with the return of the NASDAQ Bank Index over the next 12-month period.
- **Underperform/Sell:** The subject stock's total return is expected to be less than the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.

Investment Rating Distributions (as of September 30, 2020)

	All Covered Companies		Investment Banking Services Provided in the Last 12 Months	
Rating Categories	**Count**	**% of Total**	**Count**	**% of Category**
Outperform/Buy	NA	0%	0	0%
Neutral/Hold	NA	0%	0	0%
Underperform/Sell	NA	0%	0	0%
Total	0	0%		

Other Important Disclosures:

J. Alden Associates, Inc. (DBA Alden Securities) is a FINRA-registered broker-dealer.

Alden Securities expects to receive compensation for investment banking services from the subject company in the next three months and/or seeks to receive such compensation.

Analyst compensation is based, in part, on Alden Securities' profitability, which includes revenues from investment banking.

Target prices, if applicable, are derived from our 12 Month Valuation Assessment. Our 12 Month Valuation Assessment is based on a blend of several relative value methodologies.

Alden Securities shares in the commissions for trades that are executed through Tourmaline Partners, LLC.